BRIEF IN SUPPORT OF PETITION FOR WRITS OF CERTIORARI.

OPINIONS BELOW.

The opinion of the Circuit Court of Appeals is not, as yet officially reported, but appears in the record at pages 69-75. The Memorandum Findings of Fact and Opinion of The Tax Court are not officially reported, but appear in the record at pages 15-23.

JURISDICTION.

The jurisdiction of this Court is discussed at page 2 hereof.

STATUTE INVOLVED.

REVENUE ACT of 1938:
Sec. 117. CAPITAL GAINS AND LOSSES.

(a) Definitions.—As used in this title:

(1) Capital Assets.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1);

* * *

(4) Long-Term Capital Gain.—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income;

* * *

(b) Percentage Taken Into Account.—In the case of a taxpayer other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

* * *

66 2/3 percentum if the capital asset has been held for more than 18 months but not for more than 24 months;

* * *

SPECIFICATION OF ERRORS.

1. The Circuit Court of Appeals erred in holding that the income here involved is not long-term capital gain.

2. The Circuit Court of Appeals erred in holding that Howell did not acquire an "economic interest" in the mineral on October 6, 1937.

3. The Circuit Court of Appeals erred in holding that Howell had no rights prior to November 16 or 17, 1937.

STATEMENT OF THE CASE.

The facts are briefly set forth at pages 3 to 6 hereof. In more detail, they are:

The taxpayer, Katie M. Howell, is an individual whose address is Electra, Texas. She is the duly appointed and acting Executrix of the estate of her deceased husband, J. H. Howell. The income tax returns of Katie M. Howell and J. H. Howell were filed on the community property basis with the Collector of Internal Revenue for the Second District of Texas (R. 15, 16).

October 5, 1937, petitioner's husband, J. H. Howell, and one W. P. Ferguson reached an understanding with respect to a contract and an oil and gas lease covering certain of Ferguson's land.

The said contract and lease were executed October 6, 1937. The contract provides (R. 28, 29):

"This contract and agreement made and entered into, this 6th day of October, A. D., 1937, by and between W. P. Ferguson of Wichita County, Texas, hereinafter called Party of the First Part, and J. H. Howell of Wichita County, Texas, hereinafter called Party of the Second Par:

"Witnesseth, said First Party is the owner of the following described land situated in Wichita County, Texas:

"All of Blocks Nos. Five (5), Seven (7), Eight (8), Nine (9), Ten (10) and Eleven (11) of the W. P. Ferguson Subdivision of the North 966 acres of the East 1800 acres of the W. H. Spillers Survey, Abstract No. 257, which said subdivision plat is of record in the Deed Records of Wichita County, Texas, and said blocks above numbered containing an aggregate of five hundred, sixteen (516) acres, more or less—

"Said Second Party herein desires to drill a well, or cause a well to be drilled on the above described tract of land:

"Now, Therefore, for and in consideration of the payment by said Second Party herein of the sum of $1.00, and other covenants and agreements hereinafter set forth, said First Party agrees to execute and place in escrow in the First National Bank of Wichita Falls, Texas, oil and gas lease covering the above described tract of land, in favor of said second party; and the said Second Party hereby agrees that he will, on or before the 21st day of November, 1937, commence the actual drilling of a well on the tract of land above described, said well to be drilled with due diligence to a depth of 4000 feet, or to a sufficient depth to test what is known as the K-M-A deep sand. In the event production of oil or gas be found in paying quantities at a lesser depth than that herein set forth, it is agreed that second party shall have the privilege of completing such well at such lesser depth, but it is further agreed that in such event, said Second Party shall, within sixty days from the completion of a well at any lesser depth, start the actual drilling of another well to be drilled to the original depth set forth herein; in other words it is the intent hereof that said Second Party shall drill a well to test the 4000 foot sand, or

what is known as the K-M-A deep sand, to fulfill the requirements of this contract.

"The lease mentioned herein is to be for a period of three years, with annual rental of $1.00 per acre; and said lease is to be delivered to said second party at the time said well is actually started.

"In Witness Whereof we have hereunto set our hands this the 6th day of October, A. D. 1937."

The lease is on the customary Texas "Producer's '88' Special Form." It provides, in the filled-in printed portion, that a well be commenced on or before October 6, 1937, the date of the lease. At the bottom of the first page, the lease contains the following typewritten statement (R. 30):

> "As a further consideration, lessee herein agrees that he will commence the actual drilling of a well on or before November 21st, 1937, on the above described acreage; said well to be drilled to a depth sufficient to test the 4000 foot or K-M-A deep sand, according to contract attached hereto and made a part hereof."

The lease was not placed in escrow with the First National Bank of Wichita Falls, Texas, as provided in the contract, but by mutual consent of the parties was left with one H. S. Gray. Under the agreement of October 5, 1937, Gray was to receive a lease on 20 acres of the land included in Ferguson's lease to petitioner's husband, J. H. Howell (R. 16-17, 39-46).

On October 26, 1937, petitioner's husband, J. H. Howell, entered into an agreement with the Consolidated Oil Company, under which he agreed "to convey to you an undivided 3/4th interest in the acreage covered by contract between myself and W. P. Ferguson, dated October 6, 1937, you to assume all the obligations contained in contract dated the same date * * *." Consolidated paid petitioner's husband $5,000 in cash in consideration for the said agreement and agreed to drill the "obligation" well (R. 18, 47-48).

The well was actually started on November 16 or 17, 1937, and on the same day Gray delivered the lease to petitioner's husband. On November 19, 1937, Howell assigned an undivided 3/4ths interest in the lease to Consolidated Oil Company. On the same date, Howell and Consolidated assigned to Gray all of their interests in the oil and gas lease insofar as it covered a described tract of land containing twenty acres, more or less (R. 18, 37-38).

On April 10, 1939, petitioner's husband, J. H. Howell, and Consolidated sold to Buffalo Oil Company their entire 7/8ths working interest in about half of the land covered by the lease. The consideration was $700,000 cash, of which Howell received $175,000 (R. 18, 38).

The Tax Court took the position that the thing owned and sold by Howell was the "lease"; that as Howell did not secure the piece of paper called a "lease" until November 16 or 17, 1937, he had held the property for less than eighteen months. The Circuit Court of Appeals followed the same reasoning, but went further. It held that oil in place was the thing sold, stating (R. 73):

> "Under the law of Texas an oil lease is a present sale of oil and gas in place. That is the substance of what taxpayer acquired when the lease in question was delivered. That is what the taxpayer sold to Buffalo Oil Company. The purchasers did not pay $700,000.00 for an 'economic interest.' They paid $700,000.00 for oil and gas in place, plus the right to take it, as evidenced and made secure to them by the execution and delivery to them of a valid and legal document, to-wit a lease."

The language quoted is the identical contention made to and rejected by this Court in *Burnet* v. *Harmel*, 287 U. S. 103.

Neither Court below cited any oil, gas or mineral decisions to support the position taken.

The taxpayer contends the only thing of value involved was the "economic interest," or right to enter upon the

land, explore for and extract the mineral. Certainly Consolidated paid Howell $5,000 and agreed to drill the "obligation" well for that "economic interest," because Howell did not have the "lease" at that time.

ARGUMENT.

Petitioner's case is outlined under "Reasons Relied On for the Allowance of the Writs," pages 5 to 12, supra. Any further statement would merely be a verbose statement of the same argument. Consequently, further argument will be eliminated.

CONCLUSION.

For the reasons stated, writs of certiorari should issue to resolve the conflicts mentioned, and to dispose of the case in accordance with the accepted and usual course of judicial proceedings.

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March, 1944.